IN THE

Supreme Court of the United States

October Term, 1975

No. 75-660

L. JOHN JACOBI and ROBERT GAMBERA, etc.,
Petitioners,

against

BACHE & CO., INC., NEW YORK STOCK EXCHANGE, INC., *et al.,*
Respondents.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

RESPONDENTS' BRIEF IN OPPOSITION TO PETITION FOR A WRIT OF CERTIORARI

WILLIAM ELDRED JACKSON
RUSSELL E. BROOKS
MARK L. DAVIDSON
Attorneys for Respondent New York Stock Exchange, Inc.
1 Chase Manhattan Plaza
New York, New York 10005

MARVIN SCHWARTZ
Attorney for Respondents Bache & Co., Inc.; Kidder, Peabody & Co., Inc.; Dean Witter & Co., Inc.; Smith, Barney & Co., Inc.; and Dominick International Corp.
48 Wall Street
New York, New York 10005

Of Counsel:

MILBANK, TWEED, HADLEY & MCCLOY
1 Chase Manhattan Plaza
New York, N. Y. 10005

SULLIVAN & CROMWELL
48 Wall Street
New York, N. Y. 10005

[The Names of the attorneys for all respondents appear at the end of the brief.]

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Counter-Statement of the Question Presented

Absent immunity, is the question of antitrust liability for securities exchange rules which are within the area of supervised self-regulation mandated by the Securities Exchange Act of 1934 to be determined by the rule of reason or by *per se* concepts?

Statutory Provisions Involved

In addition to Section 1 of the Sherman Antitrust Act, 15 U.S.C. § 1 (Pet. p. 3), there is also involved Sections 6(a)(4) and 19(b) of the Securities Exchange Act of 1934

("the Exchange Act"), 15 U.S.C. §§ 78f(a)(4) and 78s(b),* reading as follows:

"Section 6. (a) Any exchange may be registered with the Commission as a national securities exchange under the terms and conditions hereinafter provided in this section, by filing a registration statement in such form as the Commission may prescribe, containing the agreements, setting forth the information, and accompanied by the documents, below specified:

* * *

"(4) An agreement to furnish to the Commission copies of any amendments to the rules of the exchange forthwith upon their adoption."

* * *

"Section 19.

* * *

"(b) The Commission is further authorized, if after making appropriate request in writing to a national securities exchange that such exchange effect on its own behalf specified changes in its rules and practices, and after appropriate notice and opportunity for hearing, the Commission determines that such exchange has not made the changes so requested, and that such changes are necessary or appropriate for the protection of investors or to insure fair dealing in securities traded in upon such exchange or to insure fair administration of such exchange, by rules or regulations or by order to alter or supplement the rules of such exchange (insofar as necessary or appropriate to effect such changes) in respect of such matters as *(1) safeguards in respect of the financial responsibility of members* and adequate provision against the evasion of financial responsibility through the use of corporate forms or special partnerships; (2) the limitation or prohibition of the registration or trading in any security within a specified period after the issuance or primary distribution thereof; (3) the listing or striking from listing of any security; (4) hours of trading; (5) the manner, method, and place of soliciting business; (6) fictitious or numbered accounts; (7) the time and method of making settlements, payments, and deliveries and of closing accounts; (8) the reporting of transactions on the exchange and upon tickers maintained by or with the consent of the exchange, including the method of reporting short sales, stopped sales, sales of securities of issuers in default, bankruptcy or receivership, and sales involving other special circumstances; *(9) the fixing of reasonable rates of commission, interest, listing, and other charges;* (10) minimum units of trading; (11) odd-lot purchases and sales; (12) minimum deposits on margin accounts; and (13) similar matters." (Emphasis added)

* All references to the Securities Exchange Act of 1934 are to the Act prior to the amendments accomplished by the Securities Reform Act of 1975, Public Law No. 94-29, signed by the President on June 4, 1975.

Counter-Statement of the Case

This action was brought by two registered representatives (securities salesmen) against New York Stock Exchange, Inc. (the "Exchange") and 27 of its member organizations on behalf of all such representatives employed by those organizations who, during the period April 2, 1970, through June 25, 1971, were compensated at least in part by sharing in a portion of the fixed minimum commissions required by Exchange rules to be charged on securities transactions effected on the Exchange. (See 46A)*

* "A" refers to the appendix filed in the Court below.

Prior to and during this period, member organizations of the Exchange were in dire financial straits and required additional revenue for survival. (293-307A) Acting pursuant to its Exchange Act obligation to protect investors from the danger of a financially insecure brokerage community (see Sections 6(d) and 19(b) (1), 15 U.S.C. §§ 78f (d) and 78s(b) (1)), the Exchange adopted a new Rule 383, which would impose an interim service charge on Exchange transactions in addition to the minimum commission. (248A-253A) The proposed rule was submitted to the Securities and Exchange Commission (the "SEC") for approval prior to its adoption in accordance with SEC Rule 17a-8 (17 C.F.R. § 240.17a-8). The Exchange advised the SEC that the new rule would be adopted pursuant to Article XV, Section 9, of the Exchange's Constitution, which expressly prohibited the sharing of service charges by member organizations with their employees. (251A-253A)

The Exchange also advised the SEC, as well as its member organizations, that despite the prohibition against sharing of the interim service charge with salesmen, compensation policies remained matters for the individual discretion of member organizations, subject only to the requirement that any increase in compensation not imperil the member organization's financial integrity. (414A) Thus, throughout the period each member organization remained free to increase or decrease salesmen's compensation in whatever way it deemed appropriate.

The prohibition of Article XV, Section 9, was the basis of petitioners' claim. They claimed that the emergency service charge should have been treated as a commission increase and that registered representatives should have been permitted an increase in compensation through sharing in the revenues generated by the service charge.

Article XV, Section 9, was at the time of the adoption of the service charge (and had been for many years) on file with the SEC as was required by Section 6(a)(3) of the Exchange Act, 15 U.S.C. § 78f(a)(3). (251-252A) Both prior to and immediately following the Exchange's submission of Rule 383 to the SEC, extensive discussions took place between the Exchange and the SEC concerning both the necessity for and the impact of the proposed new rule. (259A-261A; 265A-274A) The SEC carefully scrutinized the rule in discharge of its Section 19(b)(1) obligation to safeguard the financial responsibility of brokerage firms doing business on registered exchanges, 15 U.S.C. § 78s(b) (1), and in exercise of its Section 19(b)(9) authority to protect investors by insuring the fixing of reasonable rates of commission and other charges, 15 U.S.C. §78s(b)(9). (259A-261A)

The SEC thereafter approved the proposed rule, but on the following conditions: (a) the Exchange must take steps to assure that all brokerage services were restored to small investors; (b) the Exchange must insure that revenues derived as the result of Rule 383 were prudently employed by member firms "to improve their operations and financial position"; (c) the Exchange must pledge to provide to the SEC continuing financial data on the operation of the service charge so that its effects could be monitored by the SEC; and (d) the service charge would expire in 90 days. (259A-261A; 414A)

Thereafter, the SEC maintained close surveillance over the administration of the service charge. (262A-264A) The data generated by such monitoring, of course, reflected that the service charge revenues were not being used to increase registered representatives' compensation. As a result, the SEC was fully aware that Article XV, Section 9, which was on file with the SEC, prohibited member or-

ganizations from sharing service charge revenues with with their salesmen. (416A)

In addition, the Association of Investment Brokers—petitioners' trade association—requested the SEC to intervene and direct the Exchange to lift its restriction. (322A) This the SEC declined to do, although noting that it would be receptive to evidence demonstrating that an exercise of its Section 19(b) authority over this matter was "necessary or appropriate". (322A) Furthermore, hearings on a proposed extension of the service charge were held by the SEC in July 1970, during which registered representatives appeared and testified, again complaining of the effects of Article XV, Section 9. (416A; 323A-326A) The SEC once more refused either to request or direct the Exchange to alter the rule. (308-326A) Instead, it affirmatively permitted the service charge to continue in effect until March of 1972. (*id.;* Pet. p. 3)

It was only when the SEC rejected the entreaties of petitioners' trade association that petitioners brought this action, claiming that Article XV, Section 9, was tantamount to an agreement among competitors to restrict the compensation of their employees and, thus, price fixing in violation of the antitrust laws.

A trial was had before the District Court. Contrary to the petition (p. 5), the District Court (23-46a)* did not find Rule 383 or Article XV, Section 9, immune from the antitrust laws, despite the uncontested fact that both were adopted pursuant to Section 19(b) of the Exchange Act and subject to SEC review. It held that petitioners had not shown that the claimed restraint was in fact price fixing. The Court found on the evidence that the Exchange's

* "a" refers to the appendix attached to the petition.

rules were designed to preserve the financial integrity of its member organizations and thus to protect their customers, the investing public. On this point the Court found:

> ". . . the service charge was approved after actual Commission scrutiny. The Commission judged it necessary for the protection of investors that immediate interim measures be taken to supply additional revenue to rapidly failing brokerage firms. In this sense, the service charge itself was necessary to make the securities laws work. Moreover, to insure that the additional charge to investors was in fact used to further the end for which it was enacted, the Commission formally required that the revenue so generated be retained by the firms effecting the transactions and be used prudently to achieve financial stability. While the Commission did not formally require that the service charge be excluded from the formulae for compensating registered representatives, and indeed, when the latter objected to the exclusion informed them that this was a matter in which it would not intervene, it is entirely consistent with the purpose for which the charge was levied, that it be so excluded. The revenue was thereby retained at the level judged most crucial, and individual firms remained free to decide for themselves whether to increase the salaries of their employees. In fact, the evidence at trial showed that the revenue generated by the service charge was insufficient to keep the firms from operating at a loss, but at best, merely stemmed the continued erosion of capital and relieved the most acute financial pressure on some of the firms. Thus, the limitations the Exchange imposed themselves furthered the purposes of the securities laws." (44a-45a)

The Court therefore concluded that the rules attacked were not price fixing rules, and that furtherance of customer protection—an Exchange Act objective—outweighed petitioners' claims for salary increases and justified any incidental anticompetitive effect on compensation.

The petition notwithstanding (see pp. 5-6, 9-10), the Court of Appeals (1-19a) did not reverse the District Court and did not premise its affirmance on *Gordon* v. *New York Stock Exchange, Inc.* — U.S. —, 95 S. Ct. 2598 (1975). Rather, the Court affirmed on the authority of this Court's opinions in *Silver* v. *New York Stock Exchange,* 373 U.S. 341 (1963), and *Board of Trade of the City of Chicago* v. *United States,* 246 U.S. 231 (1918), and endorsed the District Court's application of a "rule of reason" approach in assessing the claimed restraint. The Court of Appeals did not affirm merely because it found that petitioners had failed to meet their burden of proof, although that indeed was the case. It also affirmed because the record amply supported the trial court's findings that the challenged rules were "germane" to the performance of the Exchange's mandated duty of self-regulation and, thus, justified as in furtherance of the objectives of the Exchange Act. Those findings were that:

> "The Rule prohibiting sharing the service charge with registered representatives was designed primarily to enable member firms to retain needed revenue, furthering the purpose which prompted imposition of the service charge, rather than to achieve any uniformity or reduction in the compensation of registered representatives. The effect of the requirement may have been in part that the registered representatives received, in general, less money than they would have absent the prohibition, although this has not been conclusively demonstrated. There was no stabilizing effect on wages, however, and no greater degree of uniformity in the compensation of registered representatives after the service charge was imposed than before. Competition continued unabated, and in at least one case a firm's increased revenue was reflected in an increase in the registered representatives' commission rate." (18a) (Footnote omitted.)

Reasons for Denying the Writ

There is no conflict between the decision below and this Court's decisions in *Gordon* v. *New York Stock Exchange, Inc., supra,* which dealt only with antitrust immunity and did not consider applicability of the rule of reason, or in *Silver* v. *New York Stock Exchange, supra,* which applied the rule of reason to Exchange conduct held not to be immune.

Moreover, the decision below has no effect on other regulated industries since the Exchange Act is unique among federal regulatory statutes in mandating self-regulation by private bodies, the exchanges, subject to review and revision by a government agency, the SEC.

ARGUMENT

I

The decision below follows this Court's decisions in *Silver* and *Chicago Board of Trade* and is not inconsistent with the Court's decision in *Gordon*.

In *Silver,* the Exchange argued that unless its withdrawal of a non-member's private wire privileges were held immune from the antitrust laws, the fear of antitrust liability would stifle Exchange self-regulatory activity contemplated by the Exchange Act. While concluding that the challenged conduct was not immune because not within the SEC's review power under the Exchange Act, this Court met the Exchange's argument by ruling that non-immune conduct which fell within the scope and purpose of the Exchange Act would be judged under the rule of reason:

> ". . . *under the aegis of the rule of reason,* traditional antitrust concepts are flexible enough to permit the Exchange sufficient breathing space within which to carry out the mandate of the Securities Exchange Act. . . . Although, as we have seen, the statutory scheme of that Act is not sufficiently pervasive to create a total exemption from the antitrust laws . . . , it is also true that particular instances of exchange self-regulation which fall within the scope and purposes of the Securities Exchange Act may be regarded as justified in answer to the assertion of an antitrust claim." (373 U.S. at 360-361) (Emphasis added)

On the facts of *Silver,* the Court found the challenged conduct unjustifiable under the rule of reason. Antitrust liability was held to exist.

The decision below was based on this Court's application in *Silver* of the rule of reason test (14a-20a), together with this Court's decision in *Chicago Board of Trade* (18a-19a), which was in turn cited as a basis for the *Silver* decision. As this Court did in *Silver,* the Court below first sought to determine whether immunity existed. Applying the reasoning of this Court's decision in *Gordon* (13a-14a), the Court of Appeals found immunity absent. The Court then went on, as did this Court in *Silver,* to consider whether the challenged conduct was within the area of supervised self-regulation contemplated by the Exchange Act in which *per se* concepts were displaced by the rule of reason. (15a-16a) The Court of Appeals found (16a-17a) the challenged conduct to be justifiable under the rule of reason on the basis of the findings of the District Court, which the Court of Appeals found to be supported by the record. See *supra,* pp. 8-9.

The decision below in no way conflicts with this Court's decision in *Gordon.* *Gordon* held that the Exchange's rules fixing minimum commission rates were immune from the antitrust laws. The Court accordingly had no reason to consider the rule of reason as the proper standard by which to judge non-immune Exchange self-regulation, as it earlier had done in *Silver.**

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* This Court's rule of reason analysis in Silver has been applied in other lower federal court decisions dealing with Exchange conduct found not to be immune. Thill Securities Corp. v. New York Stock Exchange, 433 F.2d 264 (7th Cir. 1970), *cert. denied,* 401 U.S. 994 (1971); Cowen v. New York Stock Exchange, 371 F.2d 661 (2d Cir. 1967); Robert W. Stark, Jr., Inc. v. New York Stock Exchange, Inc. 346 F.Supp. 217 (S.D.N.Y.), *aff'd per curiam,* 466 F.2d 743 (2d Cir. 1972); J. R. Williston & Beane, Inc. v. Haack, 387 F.Supp. 173 (S.D.N.Y. 1974) *See also* United States v. Morgan, 118 F.Supp. 621, 689, 694 (S.D.N.Y. 1953).

II

The decision below does not apply to any other regulated industry.

There is no ground for petitioners' claim that the decision below will create a "no-man's land" in which regulated industries are permitted to engage in "reasonable" price fixing not subject to regulation. (Pet. p. 11) This Court's decision in *Silver,* as well as the decision below, are clear that the rules of antitrust liability applied in both cases are unique to the scheme of self-regulation contemplated by the Exchange Act. It is clear from the quotation from the *Silver* decision relied upon by the Court below that its holding relates only to "particular instances of exchange self-regulation which fall within the scope and purposes of the Securities Exchange Act [which] may be regarded as justified in answer to the assertion of an antitrust claim." (15a)

CONCLUSION

The petition for a writ of certiorari should be denied.

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Respectfully submitted,

WILLIAM ELDRED JACKSON
RUSSELL E. BROOKS
MARK L. DAVIDSON
Attorneys for Respondent New York Stock Exchange, Inc.
1 Chase Manhattan Plaza
New York, New York 10005

Of Counsel:

MILBANK, TWEED, HADLEY & McCLOY
1 Chase Manhattan Plaza
New York, New York 10005

MARVIN SCHWARTZ
Attorney for Respondents Bache & Co., Inc.; Kidder, Peabody & Co., Inc.; Dean Witter & Co., Inc.; Smith, Barney & Co., Inc.; and Dominick Internationl Corp.
48 Wall Street
New York, New York 10005

SULLIVAN & CROMWELL
48 Wall Street
New York, New York 10005

ANTHONY R. MANSFIELD
KENNETH J. KELLY
Attorneys for Respondent Rauscher Pierce Securities Corporation
63 Wall Street
New York New York 10005

SEWARD & KISSEL
63 Wall Street
New York, New York 10005

LINDSAY A. LOVEJOY, JR.
Attorney for Respondents Lehman Bros. and Tucker Anthony & R. L. Day
1 Battery Park Plaza
New York, New York 10004

SIMPSON, THACHER & BARTLETT
1 Battery Park Plaza
New York, New York 10004

Winthrop, Stimson, Putnam & Roberts
40 Wall Street
New York, New York 10005

Stephen A. Wiener
Theodore Weitz
Attorneys for Respondents Bear, Stearns & Co. and R. W. Pressprich & Co., Inc.
40 Wall Street
New York, New York 10005

Gifford, Woody, Carter & Hays
14 Wall Street
New York, New York 10005

L. Mifflin Hays
Louis Proyect
Attorneys for Respondent Harris, Upham & Co.
14 Wall Street
New York, New York 10005

E. Michael Growney, Jr., Esq.
Attorney for Respondent Spencer Trask & Co., Incorporated
60 Broad Street
New York, New York 10005

Shearman & Sterling
53 Wall Street
New York, New York 10005

George J. Wade
Attorney for Respondent W. E. Hutton
53 Wall Street
New York, New York 10005

Hall, McNicol, Marret & Hamilton
330 Madison Avenue
New York, New York 10017

William C. Bieluch, Jr.
Attorney for Respondent Thomson & McKinnon Auchincloss Inc.
330 Madison Avenue
New York, New York 10017

Breed, Abbott & Morgan
1 Chase Manhattan Plaza
New York, New York 10005

Joseph P. Dailey
Attorney for Respondent Walston & Co., Inc.
1 Chase Manhattan Plaza
New York, New York 10005

Nathan Leventon, Esq.
Attorney for Respondent Steiner, Rouse & Co., Inc.
261 Broadway
New York, New York

Moses & Singer
51 West 51st Street
New York, New York 10019

David B. Eizenman
Attorney for Respondent L.F. Rothschild & Co.
51 West 51st Street
New York, New York 10019

Spear & Hill
1 State Street Plaza
New York, New York 10004

Eliot Lumbard
Laurence Grosberg
Attorneys for Respondent Reynolds & Co.
1 State Street Plaza
New York, New York 10004

Bressler, Meislin & Lipsitz
90 Broad Street
New York, New York 10004

Steven Lipsitz
Attorney for Respondent Pressman Frolich & Frost Incorporated
90 Broad Street
New York, New York 10004

Beekman & Bogue
5 Hanover Square
New York, New York 10005

Milton Weiss
Attorney for Respondents Hornblower & Weeks-Hemphill, Noyes and Paine, Webber, Jackson & Curtis
5 Hanover Square
New York, New York 10005

Brown, Wood, Fuller,
Caldwell & Ivey
1 Liberty Plaza
New York, New York 10006

James B. May
Thomas J. Mullaney
Attorneys for Respondent
Goodbody & Co.
1 Liberty Plaza
New York, New York 10006

Cahill, Gordon & Reindel
80 Pine Street
New York, New York 10005

David R. Hyde
George Wailand
Attorneys for Respondent
Loeb, Rhoades & Company
80 Pine Street
New York, New York 10005

Fried, Frank, Harris,
Shriver & Jacobson
120 Broadway
New York, New York 10005

Leslie A. Blau
Attorney for Respondent
Halle & Stieglitz, Inc.
120 Broadway
New York, New York 10005

Finley, Kumble, Heine,
Underberg & Grutman
477 Madison Avenue
New York, New York 10022

Herbert Roth
Attorney for Respondent
Newburger, Loeb & Co.
477 Madison Avenue
New York, New York 10022

Guggenheimer & Untermyer
80 Pine Street
New York, New York 10005

Marvin E. Pollack
Attorney for Respondent
Oppenheimer & Co.
80 Pine Street
New York, New York 10005